

Credit & Restructuring Club 9/23 GBM

Intro to Financial Restructuring





Agenda

- 1** Intro to CRX
- 2** Schedule for Fall 2024 Semester
- 3** Introductory Concepts
- 4** Resources

CRX Introduction

Club Goals

- ✓ Educate open membership on historically opaque credit and restructuring concepts
- ✓ Prepare members to successfully recruit for competitive credit and restructuring internships and full-time roles
- ✓ Host guest speakers from top restructuring investment banks and credit investing firms

Historic Placement



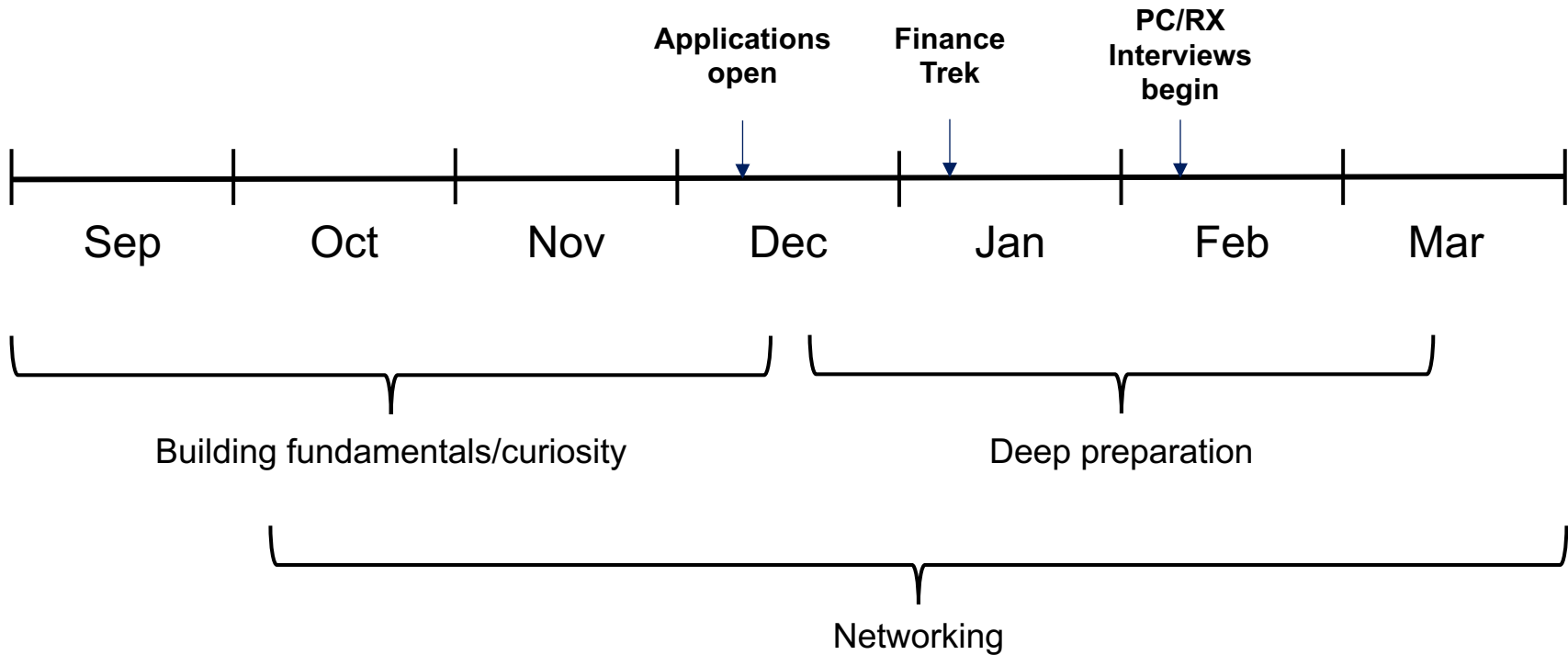


Fall 2024 Tentative Club Schedule

- **9/23:** Intro Meeting
- **9/30:** Accounting and Valuation Quick Overview
- **10/7:** Intro to Debt
- **10/17:** Blackstone Credit Guest Speakers
- **10/21:** Prof Smith RX 101
- **10/28:** Max Frumes (Caesars Palace Coup) Guest Speaker
- **11/4:** Recruiting Walkthrough
- **11/11:** Intro to Liability Management
- **11/19:** Evercore Guest Speaker
- **12/2:** Summer Analyst Experience Discussion



Private Credit and Restructuring Recruiting Timeline

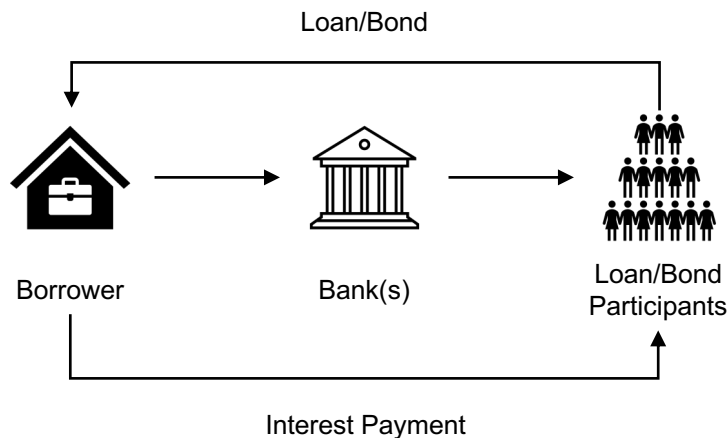


What is Private Credit?

- **Private credit streamlines lending processes**

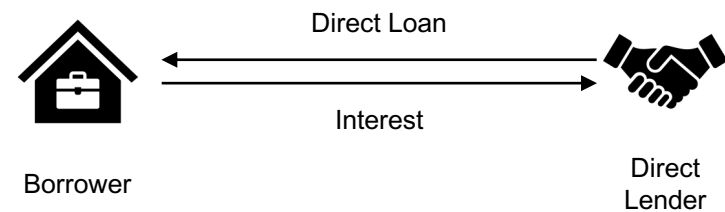
BROADLY SYNDICATED LOANS

- Businesses need capital to expand, operate, complete acquisitions, and pursue opportunities.
- Traditionally, companies borrow from commercial banks, who sell (syndicate) those loans/bonds to a large group of lenders.



PRIVATE CREDIT

- Private credit can offer companies a more direct and efficient way to access capital.
- Private credit managers raise funds directly from investors and lend to corporate borrowers in transactions that typically involve a private equity firm.
- Direct approach can result in greater efficiency, confidentiality, certainty of execution, and flexibility in terms of structure for the borrower.
- For the lender, it can lead to more attractive returns.



Why Private Credit?

Private Credit: What You Need to Know

01

Growing Demand

When added to a traditional balanced portfolio of stocks and bonds, private credit can offer **meaningful diversification** and improve risk-return potential.

02

Defensive Income

Private loans are typically **senior secured** with meaningful cushion below in the form of junior debt and equity. Also, they typically offer floating rate coupons. These features aim to provide investors with principal protection and **high income potential**.

03

Core Allocation

Privately held companies **focused on growth** and transformation have increasingly turned to private credit as a source of capital. Working with non-bank lenders, these companies are seeking to meet their capital needs more efficiently through **direct loans**.

PRIVATE CREDIT ATTRACTIVENESS:

- Increased volatility in public markets and growing investor comfort with private financing have helped accelerate the trend.
 - Interest rates are high and likely to stay there ... tracking the FED Guidance, CPI, PPI, and much more.
 - A recession can't be ruled out in the US and Europe.
 - Investors may be able to capitalize on all of these dynamics by acquiring discounted consumer and commercial loans from banks eager to reduce risk and raise liquidity.
- The evolution of private credit has been driven by direct lending, which today represents nearly half of the entire private credit market.
- As banks continue to retreat from lending, we expect this sector to continue to provide attractive long-term opportunities for investors.

What is Restructuring?

- The need for a restructuring arises with financial distress

FINANCIAL DISTRESS

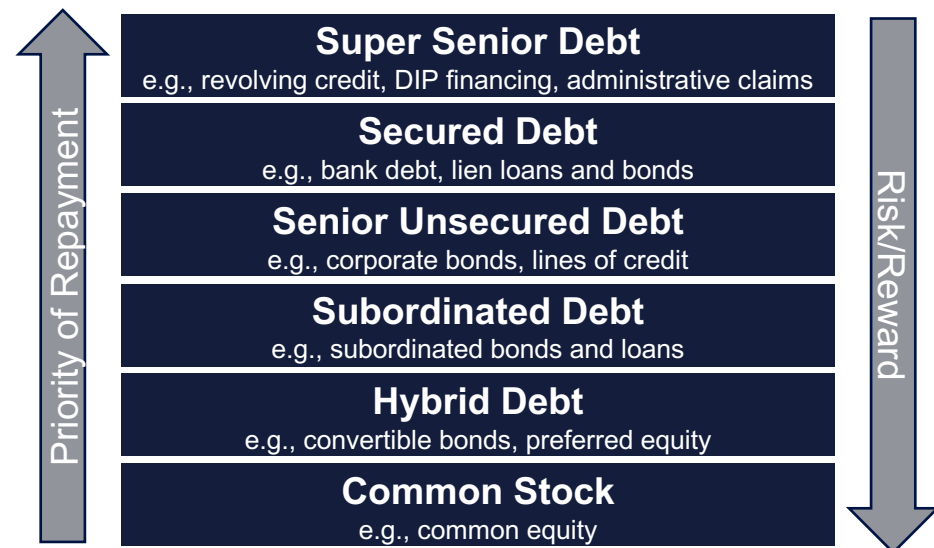
- Firm cannot meet upcoming obligations or has breached a covenant
 - Expecting to miss interest/principal payments
 - Leverage ratio past maximum threshold
- A firm must have obligations to be in financial distress
 - Bad businesses can exist forever as long as they have no debt

WHAT RESTRUCTURING INVESTMENT BANKS AIM TO DO

- Restructuring banks can either represent the debtor (company) or creditors (lenders)
 - **Debtor-side:** role is to understand the capital structure and find creative solutions to ensure the company's long-term sustainability
 - **Creditor-side:** role is to advocate for creditors and maximize returns
- Restructuring groups are typically within boutique and middle-market banks but there are some standalone

SIGNS AND CAUSES OF FINANCIAL DISTRESS

- **Identifying distress (non-exhaustive):**
 - Upcoming maturities on debt & limited liquidity
 - Debt/equity trading down significantly
 - Credit rating downgrades
- **Causes of distress:**
 - Bad strategy (operational, leverage/hedging)
 - Adverse economic conditions
 - Legal issues



Why Restructuring?

- **More variety and strategic thinking than other banking jobs**

MORE VARIETY IN DAY-TO-DAY

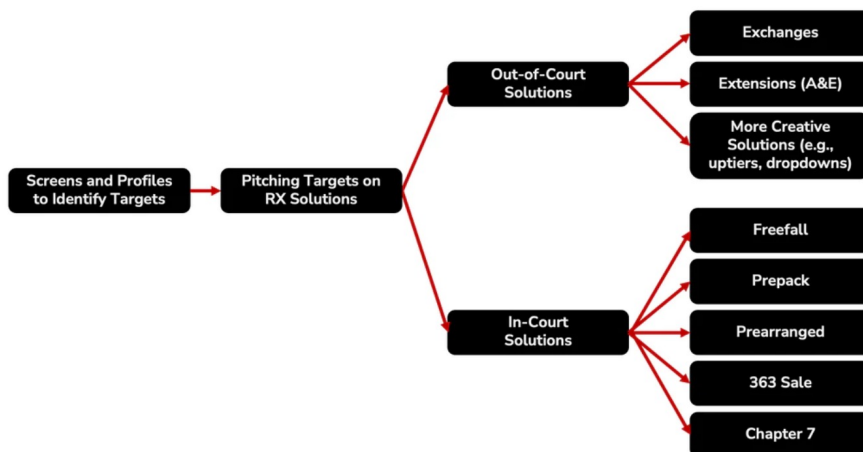
- No two processes look the same—high complexity necessitates high levels of creativity
- Potential to get in-depth understanding of the operations/considerations of **both** creditors and distressed businesses
- All of this in addition to distressed M&A processes—builds larger overall financial skillset and opens more doors

EXPOSURE TO LEGAL & GAME THEORY CONCEPTS

- Credit and bankruptcy legal frameworks are complex and few non-lawyers have the same degree of exposure as RX bankers
- Creditor positioning introduces game theory
 - Must satisfy key creditors to complete a restructuring, which involves concessions
 - Recoveries are zero sum, where no one party can be made better off without making another worse off

EXPOSURE TO DEBT / PATH INTO DISTRESSED INVESTING

- Restructuring analysts get more exposure to debt and capital structure dynamics than analysts in other areas of banking
- Distressed buy-side shops actively recruit out of restructuring banks
- UVA -> RX Bank -> Distressed fund pipeline



Current Restructuring Market

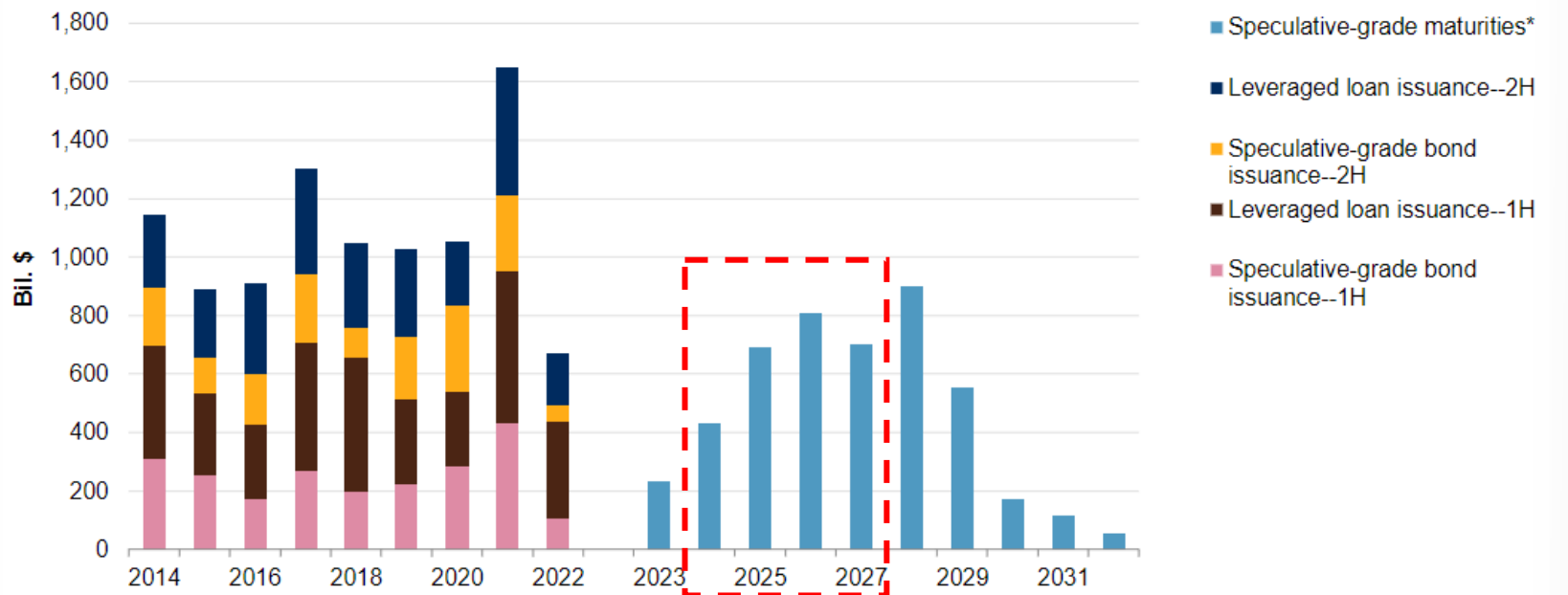
• US corporations face large refinancing issues

DEBT ISSUANCE AND REFINANCING IN ZERO RATE PERIOD

- Nonfinancial corporations issued unprecedentedly high levels in debt in 2020 and 2021, taking advantage of the zero-rate environment to refinance existing obligations
- High yield debt (rated BB+ or below) faces large maturity walls beginning in 2024 related to this debt issuance

TIGHTER CREDIT MARKETS WILL IMPACT REFINANCING

- Credit markets are currently much tighter than in 2020 as the fed has raised rates to 20-year highs and investors don't expect a rapid reduction over coming years
- For speculative companies who issued debt in 2020, this will make it (1) harder to issue new debt to refinance and (2) refinanced debt will have more burdensome interest



2024-2027 High-Yield Debt Maturity Wall (\$2.6T)

Conceptual Overview

- Why have a restructuring?

POOR BUSINESS PLAN



PANDEMIC

J. CREW

OVERLEVERAGE



NATURAL DISASTER LIABILITY



Interplay between Restructuring and Private Credit

- Private Credit has recently become a player in RX

PRIVATE CREDIT IN-HOUSE “WORKOUT” GROUPS

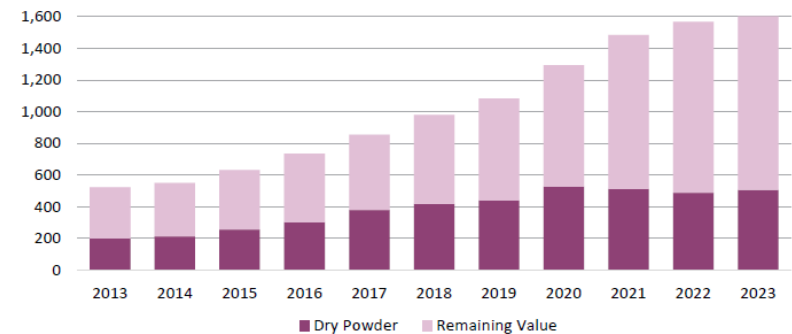
- PC funds will often have their own “workout” group that functions as their own restructuring team
- This team gets involved with non-performing credits within a portfolio
- Private credit firms are *initial issuance* holders and often hold a significant percentage of a given tranche of debt

PLURALSIGHT

- Blue Owl and other lenders had previously lent to Vista Equity’s 2021 LBO take-private of Pluralsight
- Business performance deteriorated, necessitating discussions between lenders and the sponsor
- Lenders signed a cooperation agreement to negotiate with Vista
- Vista lent to unrestricted subsidiary so Pluralsight could make immediate interesting payment before “handing the keys” over to lenders, equitizing the debt

FIGURE 1 PRIVATE DEBT MARKETS HAVE GROWN RAPIDLY IN SIZE

As of June 30, 2023 • US\$B • Private Debt Assets Under Management



Source: Pitchbook.

BX VISIT

- Blackstone’s credit group will visit 10/17
- Some of the UVA team focuses specifically in direct lending
- They will go over a name (a real company they lent to) that went through a restructuring process

Conceptual Overview

• What defines a financial restructuring?

Operational

- Concerned with turning around the day-to-day failures of a business
- In some way changing the client's *product* or *process*
- “Just make more money”
- Changing left side of Balance Sheet: Assets

- Solution: Management Consultants, Management, Acquisitions

Financial

- Concerned with addressing the capital structure of a business
- Creating runway/financing for operational turnaround
- Changing right side of Balance Sheet: Liabilities

- Solution: Restructuring Investment Bankers, Turnaround Consultants

Key Parties and Rights

• Which parties are involved in a restructuring process?

THE DEBTOR AND ITS MANAGEMENT

- Independent management teams are often hesitant to initiate restructuring discussions because of concern about losing their jobs and reputation; they will often wait far too long for a business turnaround that isn't coming
- Private equity sponsors are typically more proactive
- Once bankruptcy is filed, management's rights become restricted

EXTERNAL ADVISORS

- **Debtor's Legal Council and Financial Advisors:** Communicate with creditors and analyze what moves the debtor can make to maximize value
 - Also draft detailed valuations and analyze different strategies' effects
- **Unsecured Creditor Committee's Legal Council and Financial Advisors:** Complete legal and financial due diligence and represent the committee in negotiations

CREDITORS

- **Secured Creditors:** Can have the most power in the process due to *adequate protection provisions*, which prevent the debtor from using secured assets in a way that would induce losses for secured creditors
- **Unsecured Creditors:** Rights are limited due to lack of a direct claim on debtor's assets
 - Organized into a committee once a chapter 11 petition is filed (often before)
 - Can recover some even if out of the money

EQUITY INVESTORS

- Equity investors are often provided with little-to-no recovery because distressed companies almost always have near-zero equity values
- **Private equity owners or otherwise controlling investors often act to the detriment of creditors** when distress becomes clear, but this is limited by *fraudulent conveyance* and *zone of insolvency* laws

Evaluating a Distressed Firm's Options

• Restructuring methodology overview

OUT-OF-COURT (CONSENSUAL) RESTRUCTURING

- Distressed companies usually attempt to resolve issues out of court with consenting lenders through a debt exchange or change of terms
- Chapter 11 bankruptcy is extremely costly to the firm because it usually is a lengthy process with extensive related fees and long-term negative impacts on the business
- Out of court restructurings have disadvantages:
 - Harder to get sufficient consenting parties because less legal structure and hold-out issue (Prisoner's Dilemma)
 - Difficult with complex capital structures and some distress requires chapter 11 to resolve (e.g., failed business plan, fraud / lawsuits, rapid decline)

IN-COURT CHAPTER 11 RESTRUCTURING

- In court bankruptcies are costly and time-consuming but have several advantages:
 - **Automatic stay:** lenders and other claimants can't pursue action against bankrupt firm (e.g., secured lender couldn't foreclose on property)
 - **DIP financing:** bankrupt firms can access additional liquidity through super senior DIP financing; must show secured creditors are adequately protected
 - **Contract assumptions and rejections:** firm can choose to reject uneconomic contracts as part of the process
 - **Cram-down provision:** the bankruptcy court can "cram-down" the plan of reorganization on non-consenting classes of debt

HOLD-OUT PROBLEM

- **Debt exchange:** lenders are exchanging at a discount usually
- Lenders can gain an economic advantage by not exchanging
- Need participation for RX to be effective



- Cram-down provisions reduce hold-out leverage
- Plan must be approved by at least one impaired class, must not unfairly discriminate, and must be fair and equitable to the objecting class

Where to Learn More about Credit

Resources Available to You!

TECHNICAL RESOURCES

- BIWS 400 Q's Guide (Generic IB Technicals)
- BIWS Debt Primer (Understand Capital Structure)
- Framework For Analyzing Businesses
 - What Makes A Good Credit Investment?
- Bond Math, RX Accounting (e.g., PIK Interest)
- Paper LBO (e.g., Peak Frameworks)

NEWSLETTERS

- High Yield Harry's Newsletter
- Private Debt Investor's Newsletter
- The Credit Crunch

BOOKS

- Howard Marks – Cycles Memo
 - Great Background & Intuition
- LCD Loan Primer
 - Not Super Relevant
- Credit Investor's Handbook by Michael Gatto
 - Chapters 1-3 (Overview)
 - Chapters 6-13 (Not Super Relevant)

PEOPLE!

- Ask people in networking calls!
- Ask upperclassmen in CRX
- Professor Smith *teaches* a Credit and Restructuring course at UVA
- Come to meetings and ask questions!



Where to Learn More about Restructuring

Resources Available to You!

RESTRUCTURING INTERVIEWS .COM GUIDES AND BLOG

- <https://restructuringinterviews.com/> (\$30)
- Probably best guide that parallels BIWS 400 Qs guides for RX
- Feel free to split the guide with a few friends

NEWSLETTERS

- Follow @restructuring_ on Instagram
 - They also write the RX Newsletter “Pari Passu”
 - Includes non-RX and is generally a great resource to learn more about investing
- Petition
 - Available on Substack. Free version is enough
 - Funny and critical of SPACs- very readable and digestible for some complex information

BOOKS

- Credit Investor’s Handbook by Michael Gatto / Distressed Debt Analysis by Stephen Moyer
 - In-depth textbooks on credit and restructuring
- Caesar’s Palace Coup
 - Narrative style description of Caesar’s and its eventual Chap 11
 - UVA Alum and HL RX head David Hilty plays a big role

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Mememes idk



"He just fucked his lenders over by transferring valuable collateral to an unrestricted sub"

5/5



Robert F. Kennedy Jr. @RobertKennedyJr
Follow ...

I'm very aware of what the average retail investor has been saying about the need for greater transparency in our markets, stronger regulatory oversight and tougher penalties for market manipulation and criminal behavior. My administration will support the Ape retail rebellion and enact aggressive Wall Street reforms.

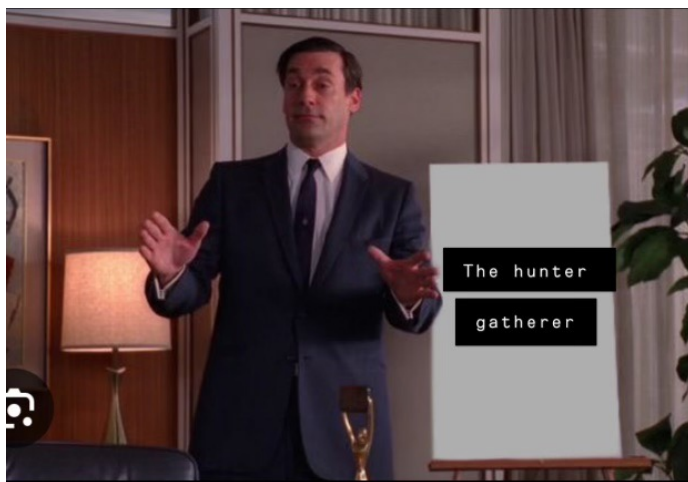
To match action with words, I just invested \$24,000 in GameStop from the fees I earned from suing Monsanto for their knowingly poisoning our soil and causing cancer. I love the idea of making Monsanto support SGME and the Apes. We need a free and fair market. Let's punish predatory short selling to the moon. By the way, I ride with you and I'm not leaving.

#ApesNotLeaving #ApesTogetherStrong #GME #AMC @TheRoaringKitty @StockRetail

ROBERT F. KENNEDY JR
INDEPENDENT FOR PRESIDENT
NOVEMBER 5TH 2024

Apes Together Strong

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High Yield Harry @HighyieldHarry
Spirit Creditors explaining their "triple dip" loan strategy



Questions?